



Semiannual Report to Congress

October 1, 1998) March 31, 1999

OIG

Office of Inspector General



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

April 29, 1999

The Honorable Alan Greenspan
Chairman
Board of Governors of the Federal Reserve System
Washington, DC 20551

Dear Chairman Greenspan:

The enclosed *Semiannual Report to Congress* summarizes activities of the Office of Inspector General for the reporting period October 1, 1998, through March 31, 1999. During this reporting period, we continued to perform a variety of audits, reviews, investigations, and special projects covering a wide range of the Board's programs and operations. For example, we

- continued our concurrent auditing of the Board's Year 2000 remediation activities working closely with Board management and staff to address this issue,
- reviewed the Board's supervisory processes for implementing regulatory changes related to the Community Reinvestment Act highlighting opportunities for improvement,
- designated over \$400,000 in questioned costs because the tax determinations made by the Board may not have been consistent with current tax laws in administering its academic assistance program.
- completed a joint audit of the Federal Financial Institution Examination Council's training program with the Inspectors General of the other agencies that make up the council, identifying areas to enhance the management of the training area, and
- continued to monitor the Eccles Building Infrastructure Enhancement Project helping to ensure that the project has sufficient management controls.

Please forward this report to the Congress together with your comments and separate management report by May 31, 1999.

Sincerely,

A handwritten signature in cursive script, reading "Barry R. Snyder".
Barry R. Snyder

Barry R. Snyder
Inspector General

Enclosure



Semiannual Report to Congress

October 1, 1998) March 31, 1999

OIG
Office of Inspector General

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INTRODUCTION

The Federal Reserve System

Congress established the Federal Reserve System (the System) as the nation's central bank in 1913. The System is structured to give it a broad perspective on the economy and economic activity in all parts of the nation. It is a federal system, composed basically of a central, governmental agency – the Board of Governors – in Washington, DC, and twelve regional Federal Reserve Banks and their Branches, located in major cities throughout the nation. These components share responsibility for supervising and regulating certain financial institutions and activities, for providing banking services to depository institutions and to the federal government, and for ensuring that consumers receive adequate information and fair treatment in their business with the banking system.

A major component of the System is the Federal Open Market Committee (FOMC), which is made up of the Board of Governors, the president of the Federal Reserve Bank of New York, and the presidents of four other Federal Reserve Banks, who serve on a rotating basis. The FOMC oversees open market operations, which is the main tool used by the Federal Reserve to influence money market conditions and the growth of money and credit.

The Board of Governors of the Federal Reserve System (the Board) was established as a federal government agency. It is made up of seven members who serve fourteen-year, staggered terms. The Chairman and Vice Chair of the Board each serve four-year terms, which can be renewed. Board members are appointed by the President of the United States and confirmed by the U.S. Senate. The Board has three primary mission areas – monetary policy, banking supervision and regulation, and oversight of Reserve Bank operations and payment systems.

Monetary Policy

The Federal Reserve System formulates and conducts monetary policy to achieve maximum sustainable long-term growth through price stability. The Board, FOMC, and other System officials use statistical data, analyses, position papers, and forecasts to support monetary policy decisions and actions and address emerging issues relating to open market, discount, and reserve requirement policies.



Banking Supervision and Regulation

The Federal Reserve is responsible for promoting a safe, sound, competitive, and accessible banking system and stable financial markets. To achieve this

The Federal Reserve supervises ...

- **992 state-chartered banks**
- **6,102 bank holding companies**
- **786 international branches of member banks**
- **84 Edge Act and agreement organizations**
- **Domestic activities of 278 foreign banks**

Source: 1997 Annual Report

mission, the Board supervises and regulates state-chartered banks, bank holding companies,

Oversight of Reserve Bank Operations

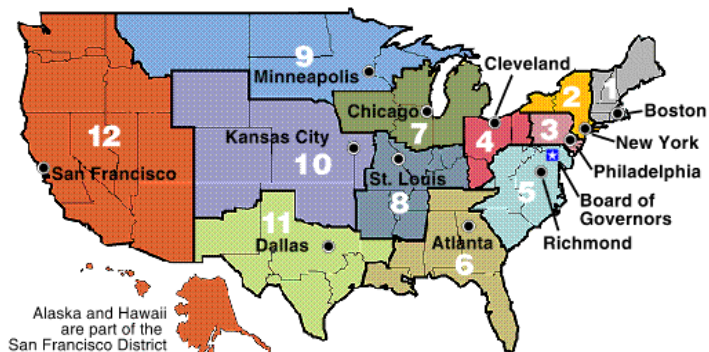
international branches of member banks, Edge Act and agreement organizations, and domestic activities of foreign banks; acts as a lender of last resort; and implements regulations designed to inform and protect consumers. The Board has delegated a portion of its supervisory and regulatory functions to the Federal Reserve Banks, including commercial bank examinations, bank holding company inspections, and approval of certain types of applications. The Board also coordinates many of its supervisory activities with other federal, state, and foreign regulators.

The Federal Reserve System plays a key role in assuring the smooth functioning and continued development of the nation's payment systems, the distribution of currency and coin, and the fiscal agency function for the U.S. Department of the Treasury. The Board

- assists in implementing Federal Reserve services so that the requirements of the Monetary Control Act are met and prices cover the costs of providing services;
- serves as the custodian and interpreter of the System's Accounting Manual and administers the production and distribution of the System's financial reports;
- ensures the accuracy and integrity of the Reserve Bank balance sheets and the safekeeping of the Banks' assets;
- reviews Reserve Bank operations for efficiency and effectiveness;

- controls Reserve Bank expenditures and financial planning; reviews plans for renovations and new Reserve Bank buildings; and
- reviews Reserve Bank data processing and

Location of Federal Reserve Banks



communications systems.

Office of Inspector General

The Office of Inspector General (OIG) was established by the Board in July 1987, and the OIG became statutorily mandated in April 1989, by the IG Act, which legislated specific duties and responsibilities and reporting relationships. Specifically, the IG Act states the Inspector General will

- provide policy direction for and conduct, supervise, and coordinate audits and investigations relating to the programs and operations of the Board;
- review existing and proposed legislation and regulations relating to the programs and operations of the Board, and make recommendations concerning the impact of such legislation or regulations on the economy and efficiency in the administration of programs and operations

administered or financed by the Board or the prevention and detection of fraud and abuse in such programs and operations;

- recommend policies for and conduct, supervise, or coordinate relationships between the Board and other federal, state, and local government agencies and nongovernmental entities with respect to all matters relating to the promotion of economy and efficiency in the administration of and the prevention and detection of fraud and abuse in programs and operations administered or financed by the Board, as well as the identification and prosecution of participants in such fraud or abuse; and
- keep the Chairman and the Congress fully and currently informed concerning fraud and other serious problems, abuses, and deficiencies relating to the administration of programs and operations administered or financed by the Board, recommend corrective actions, and report progress made in implementing corrective actions.

In addition, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991 requires the OIG to conduct reviews of certain failed depository institutions whose failure results in a material loss to the bank insurance funds.

AUDIT ACTIVITIES

Projects Completed During the Reporting Period

Audit of the Board's Year 2000 Activities

We began our oversight of the Board's Year 2000 activities in early 1997 and formally initiated three ongoing audits at the beginning of 1998. The objectives of these audits are to

- evaluate the System's efforts to address Century Date Change (CDC) compliance by supervised organizations;
- monitor the Board's oversight of the System's progress in achieving century date compliance for the Reserve Bank operations and payments systems; and,
- evaluate the Board's progress in meeting key milestones related to internal operations.

We have been coordinating our work with the U.S. General Accounting Office (GAO), which has also reviewed the progress of the Board's century date change program, primarily in the supervision and Reserve Bank operations and payments systems areas.

In our continued effort to provide timely feedback on the Board's Year 2000 activities, we issued our fourth interim assessment of CDC activities relating to supervised institutions on January 26, 1999. This assessment addressed the Phase II element of the Year 2000 Supervision Program, which covered the nine months ending March 31, 1999. During Phase II, the Federal Reserve focused on supervised institutions'

CDC testing, implementation, and contingency planning and their compliance with key dates established by Federal Financial Institutions Examination Council (FFIEC) guidelines. Our audit of Phase II supervision activities included visits to five Reserve Banks, where we reviewed a sample of Phase II examination work papers and reports and interviewed responsible officers and staff. Based on this sample review and the comments of examination personnel, we believe that the FFIEC work program for Phase II provided adequate guidance for examiners reviewing the CDC preparations of supervised organizations.

In our assessment, we suggested actions needed to further strengthen the Board's Year 2000 Supervision Program. We reiterated our view that the Division of Banking Supervision and Regulation (BS&R) should take additional steps to ensure that sufficient information technology examination personnel are deployed around the System. In addition, we suggested that BS&R (1) issue supplemental Phase II guidance on CDC ratings, (2) enhance quality assurance reviews of CDC examination reports, and (3) direct Reserve Banks to include all CDC examination letters and reports in the tracking database. We provided these suggestions, to the BS&R officer responsible for the Year 2000 Supervision Program, who discussed these issues with System Year 2000 contacts. BS&R management plans to address the issues noted in the interim letter.

With respect to the Board's internal operations, we have continued to provide feedback as we work with staff across the divisions to ensure consistency and coordination of application testing, business continuity and contingency planning, and event management planning. We are completing test documentation

reviews of the Board's 141 medium critical applications and are providing guidance in resolving discrepancies. We are also coordinating with the Board's external consultant, KPMG Peat Marwick, on a more detailed review of the Board's sixteen mission-critical applications. Our assessment of the business continuity and contingency plans has stressed the need to perform testing to validate the plans. We are also providing feedback to the Board's Year 2000 Event Management Team regarding plans and strategies.

Overall, we believe that the officials responsible for the System's Year 2000 efforts have continued to display strong leadership and commitment in ensuring appropriate oversight of the areas we are reviewing. During the next period, we will continue to follow up on the issues noted in our interim assessments and monitor the status of the System's Year 2000 progress in such areas as CDC contingency testing, event management planning, and international coordination.

[Audit of the Board's
Supervisory Processes for
Implementing the Community
Reinvestment Act](#)

The Community Reinvestment Act of 1977 (CRA) requires the federal financial supervisory agencies to use their examination and regulatory authority to assess an institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operations. The Board's Division of Consumer and Community Affairs (C&CA) carries out the Board's responsibilities under the CRA. C&CA formulates regulations, develops and administers supervision policies and procedures, oversees and coordinates the supervisory work of the Reserve Banks, and participates in FFIEC activities to promote consistency among the federal financial supervisory

agencies. The Reserve Banks' supervision personnel conduct CRA examinations under delegated authority

from the Board as part of a broader consumer compliance examination program.

At the request of the President, the supervisory agencies revised their CRA regulations in 1995 to make CRA examinations more reflective of actual performance, to achieve greater consistency in CRA evaluations, and to lessen the burden associated with CRA regulations. Although the revised regulations were not fully effective until July 1997, the agencies began assessing the implementation of the revised CRA evaluation criteria for small institutions through an interagency workgroup formed in 1996. In December 1997, the supervisory agencies also began a joint project to improve CRA evaluations of large institutions by conducting joint examinations and reviewing a sample of CRA performance evaluation reports.



We performed our audit to determine whether the Board's supervisory processes were achieving the goals of its revised regulation and to identify opportunities to improve the implementation of the revised CRA evaluation process. To do so, we evaluated the policies and procedures used to conduct and report CRA examinations, reviewed the adequacy of interagency coordination efforts to achieve consistency in CRA evaluations, and obtained the views of industry representatives and community groups.

Overall, we found that the Board's supervisory processes associated with the revised CRA regulation have resulted in examinations that emphasize an institution's performance in the areas of lending, investments, and services without imposing unnecessary regulatory burden. Industry representatives and community groups whom we contacted generally concurred that the revised regulation has resulted in more performance-oriented CRA evaluations. The Board and the other supervisory agencies have devoted considerable time and energy to interagency coordination efforts, such as uniform examination procedures and guidance in the form of interpretive letters and questions and answers, that have fostered more consistent application of the regulations among the agencies.

Although good progress has been made, we identified additional opportunities for improvement. Our report contained three recommendations to enhance the consistency of CRA evaluations and five recommendations to improve the efficiency and effectiveness of CRA supervisory processes. The Director of C&CA concurred with all but one of our recommendations and said that many of our recommendations coincided with issues identified by Federal Reserve workgroups and interagency efforts, and that some of our recommendations would be fulfilled by initiatives that were either planned or under way. However, we are concerned because the director said that action on two recommendations, pertaining to the definition of community development and CRA ratings for performance criteria of large institutions, was not likely until the next scheduled review of the regulation in 2002.

Audit of the Board's Academic Assistance Program

The Board established an Academic Assistance Program to provide financial assistance to employees taking courses related to their current jobs or other jobs at the Board. The Academic Assistance Program, managed by the Human Resources function, not only helps current employees become more valuable, knowledgeable, and productive but also assists the Board in attracting and recruiting new employees. We performed this audit to assess the adequacy of internal controls over the Board's Academic Assistance Program.

Overall we found that the Academic Assistance Program lacks an effective system of internal controls. As a result, the Board has little assurance that the program

- achieves its objective of providing financial assistance for Board-related courses to enhance employee work performance and career development,
- complies with applicable laws and regulations, or
- expends funds for the intended purposes and in accordance with Board policy.

We also designated an estimated \$409,000, or slightly more than 50 percent of the academic assistance funds expended during 1997 and through August 1998, as *questioned costs* because we believe that tax determinations for these amounts may not have been consistent with federal internal revenue laws and regulations.

Our report provided ten recommendations designed to establish an internal control framework for the

Academic Assistance Program. First, we recommended that the program be brought into compliance with Internal Revenue laws and regulations by conducting a case-by-case review of academic assistance payments to determine their taxability. The next eight recommendations focused on establishing controls over the academic assistance approval, processing, and reporting functions. Our final recommendation focused on defining and communicating clear roles and responsibilities, establishing internal operating procedures, and providing sustained oversight, supervision, and training to ensure that policies and procedures are effectively implemented.

The Staff Director of Management concurred with each of the ten recommendations and expected to implement the associated changes no later than April 1, 1999. The General Counsel's response indicated general agreement with recommendations regarding the concern over compliance with applicable laws and regulations. The General Counsel also noted that the Legal Division had been working with the Management Division and had identified situations involving taxable income for 1998, which the Management Division resolved before W-2 forms were sent to employees.

When Congress established the FFIEC in 1979, it directed the FFIEC to conduct schools for examiners and assistant examiners of the five member agencies, with such schools open to employees of state financial institution supervisory agencies. This training was mandated to help the FFIEC achieve its mission of promoting consistent and vigilant supervision of depository institutions. In 1989, the Financial Institutions Reform, Recovery, and Enforcement Act directed the FFIEC to provide risk management

seminars for regulators and managers of financial institutions. The FFIEC was free to decide (1) the specific goals, objectives, and magnitude of the FFIEC's training effort relative to each member agency's examiner training programs and (2) how the training activity should be organized, staffed, managed, and funded.

We collaborated with the Inspectors General of the Department of the Treasury, National Credit Union Administration, and Federal Deposit Insurance Corporation (FDIC) to determine whether (1) the goals of the FFIEC's training program are being met, (2) the Task Force on Examiner Education (TFEE) is an efficient and effective vehicle for guiding the FFIEC's training program, and (3) the current budget process adequately serves the goals and objectives of the FFIEC's training program.

The interagency review team found that the FFIEC is meeting its legislative mandate by sponsoring the required risk management seminars and delivering seminars and training courses attended by examiners, assistant examiners, and state supervisory personnel. The program consists primarily of conferences and seminars on specialized topics that are a supplement to, rather than an integral part of, the member agencies' own examiner education programs. Although such a role may be appropriate, it appears to be the result of processes designed to maintain each agency's organizational culture and approach to specific examination issues, rather than arrived at through an effective management planning process that would ensure that member agencies maximize the benefits of the FFIEC program in relation to their own programs.

Review of the Board's
Report Clearance Process

The joint audit report contains four recommendations to improve program management and effectiveness and discusses options and considerations for implementation. Specifically, the report recommends that the FFIEC

- implement a strategic planning process,
- realign roles and responsibilities of its task forces,
- encourage more information sharing among member agencies regarding course development activities, and
- modify the current approaches to course scheduling, budgeting, and cost sharing to encourage greater use of the programs.

Responding on behalf of the FFIEC, the Executive Secretary stated that the council was generally receptive to these recommendations and that the FFIEC had charged one of its members, the TFEE Chair, and the Executive Secretary to develop a recommended course of action for discussion at its next meeting. The Executive Secretary also indicated that the implementation process could be greatly enhanced with continued assistance and guidance from the interagency review team. The Inspectors General intend to provide appropriate assistance as requested. The FDIC's Office of Inspector General, as the lead agency on this audit, will also periodically monitor the status of the recommended actions.



Categories of forms

[Financial Statements](#)

[Applications/structure change](#)

[FFIEC](#)

[Monetary policy](#)

[Research](#)

[Business/consumer credit](#)

[Securities \(Regs. T,U,X\)](#)

[Activities monitoring](#)

Since 1975, the Board has followed a systematic process for reviewing each Federal Reserve information collection to ensure that data are needed and obtained in the most appropriate manner, considering Federal Reserve collection cost and burden on reporting entities. In 1984, the Office of Management and Budget (OMB) took this

process into consideration when it issued rules implementing the Paperwork Reduction Act of 1980. In the rules, OMB delegated authority to review and approve Federal Reserve information collections to the Board, provided that the Board's process adhered to OMB's guidelines and provided for public participation. Congress subsequently passed the Paperwork Reduction Act of 1995 (PRA) to reinforce the provisions of the 1980 act by strengthening OMB's oversight of agency information collection review processes. In its 1996 implementing regulations, OMB continued its delegation of review authority to the Board, providing that the delegation could be rescinded should OMB determine that the Board's process is not adhering to requirements.

Under its delegated authority, the Board approves information collection proposals and assigns to each information collection an OMB control number and an expiration date (usually three years from the date of approval). Before the expiration date, the Federal Reserve must complete a zero-based review to justify the continued need for the information and to ensure that the information collection burden and cost are minimized. The Board's process is the responsibility of the Committee on Economic Affairs (EA committee) and has been carried out throughout its history by the Financial Reports Section (section) of

the Division of Research and Statistics (R&S). The section schedules the required reviews, assists Board and Reserve Bank staff in developing acceptable information collection proposals, schedules and prepares materials for report clearance meetings, and acts as the liaison to OMB and other agencies involved with information collections. The Board annually reviews about one-third of the Federal Reserve's 101 information collections.

In our *1998-1999 Biennial Plan*, we identified the Board's report clearance process as a potential audit area. During December 1998 and January 1999, we assessed whether a scheduled audit of the Board's report clearance process was warranted. To make this assessment, we compared key elements of the Board's process requirements and performance criteria contained in the PRA and OMB's implementing regulations and guidance. Our objective was to look for indications of noncompliance, inefficiency, or ineffectiveness and to determine whether an audit could help improve the current process.

Our initial work indicated that an audit of the report clearance process is not warranted at this time because the process is operating in conformance with applicable OMB regulations and is resulting in changes that reduce regulatory burden. We found, however, that the Board was having some difficulty completing action on information collections before the expiration date, and we suggested to program officials that they increase the visibility of milestones for proposal development and provide an annual performance reporting on timeliness to the EA committee. The officials intend to implement both suggestions.

Audit of the Federal Reserve
Employee Benefits System's
Financial Statements

As part of a public accounting firm's financial statements audit of the Federal Reserve Employee Benefits System for the year-ended December 31, 1998, we performed, upon request, certain procedures relating to key controls that affect the Board's Employee Benefits System. We found no material exceptions to report.

Required Reporting on
Completed Audits

As required by the IG Act, we have included tables 1 and 2 to summarize the *questioned costs* and *funds for better use* that we identified during this reporting period.

Table 1**Audit Reports Issued with Questioned Costs For the Period October 1, 1998
through March 31, 1999**

Reports	Number	Dollar Value	
		Questioned Costs	Unsupported Costs
For which no management decision had been made by the commencement of the reporting period	0	\$0	\$0
That were issued during the reporting period	1	\$409,000	\$0
For which a management decision was made during the reporting period	0	\$0	\$0
(i) dollar value of disallowed costs	—	—	—
(ii) dollar value of costs not disallowed	—	—	—
For which no management decision had been made by the end of the reporting period	1	\$409,000	\$0
For which no management decision was made within six months of issuance	0	\$0	\$0

Table 2**Audit Reports Issued with Recommendations That Funds Be Put to Better Use for the Period October 1, 1998 through March 31, 1999**

Reports	Number	Dollar Value	
		Questioned Costs	Unsupported Costs
For which no management decision had been made by the commencement of the reporting period	0	\$0	\$0
That were issued during the reporting period	0	\$0	\$0
For which a management decision was made during the reporting period	0	\$0	\$0
(i) dollar value of recommendations that were agreed to by management	—	—	—
(ii) dollar value of recommendations that were agreed to by management	—	—	—
For which no management decision had been made by the end of the reporting period	0	\$0	\$0
For which no management decision was made within six months of issuance	0	\$0	\$0

Ongoing Projects

Audit of the Board's and FFIEC's Financial Statements

The independent public accounting firm of Deloitte & Touche, LLP was contracted to conduct a financial audit of the Board's financial statements and the separate statements of the FFIEC, for which the Board provides accounting services for the year-ended December 31, 1998. The audit is designed to obtain reasonable assurance that the financial statements are free of material misstatements and includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our office will ensure that the firm performs these audits in compliance with Government Auditing Standards. The result will be reported in the next semiannual report.

Review of the Board's Frequent-Flyer Policy

In March 1999, we initiated a review of the Board's frequent-flyer policy. Our overall objectives are to evaluate alternatives for implementing an economic, efficient, and effective frequent-flyer program to help the Board maximize the benefit of employee participation in airline frequent-flyer programs and to evaluate compliance by frequent travelers with the current Board policy.

During the course of the audit, we will examine the Board's plans for implementing a gain-sharing program in light of recent changes in the Board's travel administration procedures as well as the experiences of other government agencies. We plan to survey Board travelers to determine the current level of participation in airline frequent-flyer programs and to solicit input on ways to implement a cost-effective program at the Board. We also plan to survey recent travelers to evaluate their compliance with the current policy regarding the use of frequent-flyer miles earned on official business.

Monitoring the Eccles Building Infrastructure Enhancement Project

The Eccles Building Infrastructure Enhancement Project is a phased renovation that is expected to take approximately forty months to complete. The objectives of the project are to

- remove pipe insulation that contains asbestos,
- correct fire and life safety deficiencies,
- replace deteriorated heating system piping, and
- install new voice and data communication cable systems.

We have been monitoring the project's design, contract solicitation, and approval phases and have offered informal suggestions to Board staff throughout the course of our work. To date, there have been no significant problems or delays, and we believe that the overall management and internal controls used during these initial phases have been satisfactory.



Construction experts we consulted have advised us that this project has inherent risk for additional costs and schedule slippage, even with solid project management and strong internal controls. The project involves demolition, construction, and abatement of asbestos in an occupied building, with nineteen distinct phases that will each include a start-up and close-down cycle as well as a "punch list" for finish work. The project's risk profile is increased by the need to relocate sixty to ninety employees during each phase and the requirement that the schedule of critical Board publications and other activities not be interrupted. Project managers are aware of these risks, and to accommodate unforeseen situations, the final budget will include contingency funds in amounts that conform to industry standards.

In light of the risks described above, we plan to continue our ongoing monitoring efforts, with an emphasis on auditing change orders, project milestones, and progress payments.

Follow-ups

Board's Procurement and Contract Management Process

During this reporting period, we completed a follow-up on our *Report on the Audit of the Board's Procurement and Contract Management Process*. This report contained sixteen recommendations that were directed at building a more effective and efficient acquisition process and strengthening the related internal control framework.

Our follow-up review involved interviewing Board management and staff associated with the acquisition process and reviewing pertinent policies and procedures as well as a small sample of actual procurements. We found that sufficient action has been taken to close thirteen of the sixteen recommendations. The three remaining recommendations which deal with better distribution of the *Procurement Manual for Technical Personnel*, upgrading current systems to allow Boardwide electronic routing and approval, and the need to file reference checks with contract files, will remain open until they have been fully addressed by management.

Records Services Image Processing System

A follow-up on our *Report on the Audit of the Office of the Secretary's Records Services Image Processing System* was completed during the reporting period. In the audit report, we had made six recommendations designed to help enhance the division's management and administration of its records services image processing environment and improve controls over records storage and retrieval. Our follow-up work involved interviews with management and staff in the Office of the Secretary and Division of Information and Resources Management as well as a review of pertinent documentation and procedures. During our

follow-up, we found that sufficient action has been taken to close all of the recommendations.

Business Process Review of Travel Administration

We interviewed Management Division officials and staff and reviewed pertinent policies and procedures to complete a follow-up on our *Report on the Business Process Review of Travel Administration*. This report contained nine action items designed to enhance the efficiency and effectiveness of the Board's travel administration process. Five of the action items related to changes to the Board's travel policies to achieve cost savings and process improvements, and the other four action items focused on automation requirements and process changes to enhance the efficiency of the travel administration process. During our follow-up, we found that the Management Division had changed their travel policy to allow directors to authorize their division's travel, which allowed us to close this recommendation. The Management Division indicated that the other eight action items be addressed when the new automated travel system is implemented. We will continue to monitor the progress made toward implementation of these items.

Consumer Compliance Examination Process

During the reporting period, we also initiated a second follow-up on our *Report on the Audit of the Board's Consumer Compliance Examination Process* to determine the status of the eleven open recommendations. These recommendations address the frequency, scope, and level of documentation of examinations; Reserve Bank access to examination data; and the use and technical design of the regression models used by the Board. Currently, we are waiting for C&CA to finalize and publish their new regulatory letter, which will address all of the open recommendations. Should C&CA publish the letter in the manner they communicated to our office, we will be able to close the remaining eleven recommendations. The result of this follow-up will be discussed in the next semiannual report.

Table 3 shows the recommendations that we are currently tracking.

Table 3**OIG Audit Reports and Recommendations**

Report No.	Audits Currently Being Tracked	Issue Date	Recommendations			Status of Recommendations ¹ Follow Up		
			No.	Mgmt. Agrees	Mgmt. Disagrees	Completion Date	Closed	Open

Monetary and Economic Policy

None currently being tracked

Supervision and Regulation of Financial Institutions

A9508	Audit of the Board's Consumer Compliance Examination Process	04/96	14	11	3	06/97	3	11
A9610	Audit of the Division of Banking Supervision and Regulation's Distributed Processing	06/97	5	5	0	08/98	2	3
A9613	Audit of the Federal Reserve System's Enforcement Activities	10/97	4	4	0	—	—	—
A9704	Audit of the Division of Consumer and Community Affairs' Distributed Processing Environment	12/97	5	5	0	—	—	—
A9709	Audit of the Federal Reserve's Implementation of the Risk-Focused Approach to Supervising Community Banks	03/98	8	6	2	—	—	—
A9710	Audit of the Federal Reserve System's Application Commitment Processing	01/98	5	5	0	—	—	—
A9808	Joint Review of the Federal Financial Institutions Examination Council's (FFIEC's) Training Program	03/99	4	4	0	—	—	—
A9810	Audit of the Board's Supervisory Process for Implementing the Community Reinvestment Act	03/99	8	7	1	—	—	—

Table 3 (continued)

¹A recommendation is closed if (1) the corrective action has been taken; (2) the recommendation is no longer applicable; or (3) the appropriate oversight committee or administrator has determined, after reviewing the position of the OIG and division management, that no further action by the Board is warranted. A recommendation is open if (1) division management agrees with the recommendation and is in the process of taking corrective action or (2) division management disagrees with the recommendation and we have referred it to the appropriate oversight committee or administrator for a final decision.

OIG Audit Reports and Recommendations

Report No.	Audits Currently Being Tracked	Issue Date	<u>Recommendations</u>			Status of <u>Recommendations</u> ¹ Follow Up		
			No.	Mgmt. Agrees	Mgmt. Disagrees	Completion Date	Closed	Open

Oversight of Federal Reserve Bank Activities

A9405	Audit of the Board Oversight of Federal Reserve Automation Consolidation	02/96	3	3	0	03/97	2	1
A9603	Audit of Board Oversight of Reserve Bank Procurement	12/96	3	3	0	03/98	1	2
A9703	Audit of the Board's Compliance with the Service Pricing Provisions of the Monetary Control Act	03/98	2	2	0	—	—	—
A9707	Audit of the Division of Reserve Bank Operations and Payments Systems' Distributed Processing Environment	03/98	3	3	0	—	—	—

Federal Reserve Board Administrative Operations

A9408	Audit of the Office of the Secretary's Record Services' Image Processing System	03/95	6	6	0	01/99	6	0
A9505	Audit of the Division of Information Resources Management's Change Control Process	02/96	4	2	2	01/98	0	4
A9507-A	Audit of the Board's Procurement and Contract Management Process	08/96	16	14	2	11/98	13	3
A9609	Audit of the Administrative Systems Automation Project (ASAP)	02/97	7	7	0	06/98	4	3
A9702	Business Process Review of the Board's Travel Administration	07/97	9	9	0	01/99	1	8
A9811	Audit of the Board's Academic Assistance Program	02/99	10	10	0	—	—	—

¹A recommendation is closed if (1) the corrective action has been taken; (2) the recommendation is no longer applicable; or (3) the appropriate oversight committee or administrator has determined, after reviewing the position of the OIG and division management, that no further action by the Board is warranted. A recommendation is open if (1) division management agrees with the recommendation and is in the process of taking corrective action or (2) division management disagrees with the recommendation and we have referred it to the appropriate oversight committee or administrator for a final decision.

INVESTIGATIVE ACTIVITIES

Overview

Our investigators continued to address allegations of wrongdoing related to the Board's programs and operations, as well as violations of the Board's standards of conduct.

The investigative function covers the full range of investigative requirements from both reactive and proactive directions. Specifically, our approach includes

- reaction to possible wrongdoing identified by others through the OIG hotline and other sources;
- reaction to possible wrongdoing through referrals from auditors, other Board program functions, Congress, and other federal, state, and local audit or law enforcement agencies; and
- attention to prevention and detection activities that both foster an environment that discourages wrongdoing and encourage close coordination with audits on risk and vulnerability surveys.

Our hotline operation is available to those who want to report wrongdoing in the Board's programs and operations (including delegated functions). The local and toll-free hotline numbers and the OIG hotline address are published in the Board's telephone directory, in an interagency hotline network publication sponsored by the President's Council on Integrity and Efficiency (PCIE), in the *Congressional Record*, in the local telephone directory, and in the telephone directories of each of the Federal Reserve Banks and Branches and their respective local telephone directories. The hotline numbers are also published in selected documents, correspondence, and reports produced by the Board and the OIG.



Inspector General Hotline

1-202-452-6400

1-800-827-3340

Report: Fraud, Waste or Mismanagement.

Information is confidential.

Caller can remain anonymous.

You can also write the:

Office of Inspector General

HOTLINE

Mail Stop 300

Board of Governors of the Federal Reserve System

20th & Constitution Avenue, N.W.

Washington, DC 20551

The OIG receives requests for investigations from within the Board and from outside sources and makes referrals to other law enforcement organizations as appropriate. The OIG's prevention and detection strategy is designed to identify causes of fraud and abuse, provide a mechanism for the early detection of fraud and abuse, minimize any potential damage or loss, and help the Board resolve such problems and prevent their recurrence, if possible.

Activity During the Reporting Period

Our investigative unit received 265 complaints during this reporting period. Of the 265 complaints received, 258 were closed after our initial analysis and contact with the complainants, where possible. Most hotline callers were consumers with complaints or questions

about practices of private financial institutions. Those inquiries involved matters such as funds availability, account fees and charges, and accuracy and availability of account records. We also continued to receive numerous questions concerning how to process Treasury securities and savings bonds. Other callers contacted us seeking advice about programs and operations of the Board, Banks, and other financial regulatory agencies. OIG investigators directed those inquiries to the appropriate Board offices, Federal Reserve Banks, or federal or state agencies. Only two of the 265 hotline complaints we received required the OIG to open formal investigations.

In addition to the hotline complaints, the investigative unit received eight allegations that were referred to the OIG from Board program staff and other sources. As a result of those allegations, the OIG opened two additional formal investigations, incorporated four of those allegations into our ongoing review of fictitious-instrument fraud complaints, and closed the two remaining allegations after further inquiry showed that no further investigative effort was warranted. The OIG initiated one additional proactive effort that was also incorporated into our fictitious-instrument fraud review. Because of the increasing number of fictitious-instrument fraud allegations being received by the OIG, we intend to devote more investigative resources to pursuing these allegations where our jurisdiction and the complaint merits such an effort. We are currently continuing to coordinate and refer this type of allegations to other law enforcement agencies where appropriate.

Fictitious-instrument fraudulent schemes are those in which promoters promise very high profits based on fictitious instruments that they claim are issued, endorsed, or authorized by the Federal Reserve System or well-know financial institutions.

During this reporting period, we closed three cases and continued work on eleven cases that were opened during previous reporting periods. The investigative findings in two of our active cases required the OIG to refer two separate cases to the local prosecutor to determine whether they merited criminal prosecution. Both cases were declined in favor of administrative action. In one case, administrative action had already taken place, and in the other case, the Board is currently considering appropriate administrative action. We have eleven active cases at the end of this reporting period. Our overall summary statistics are provided in table 4.

Table 4**Summary Statistics on Investigations for the Period of October 1, 1998 through March 31, 1999**

Hotline

Complaints Received (calls, letters, or other contacts)	265
Complaints Closed	258

Referrals for Investigations

Hotline Referrals	256
Audit Referrals	0
Referrals from Other Board Offices	2
Referrals from Other Sources	6

Proactive Efforts by OIG

Investigations Developed by OIG	1
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Total of Hotline Complaints, Referrals, and Proactive Efforts Received during Reporting Period265

Investigative Caseload

Investigations Opened During Reporting Period	3
Investigations Open from Previous Periods	11
Investigations Closed During Reporting Period	3
Total Investigation Active at End of Reporting Period	11

Investigative Results for this Period

Referred to Prosecutor	2
Referred for Audit	0
Referred for Administrative Action	1
Oral and/or Written Reprimand	0
Terminations of Employment	0
Suspensions	0
Debarments	0
Indictments	0
Convictions	0
Monetary Recoveries	\$0
Civil Actions (Fines and Restitution)	\$0

REVIEW OF LEGISLATION AND REGULATIONS

Overview

We review existing and proposed legislative and regulatory items both as part of our routine activities and on an ad hoc basis. We usually review existing laws, regulations, and policies and procedures that affect the Board as part of scheduled audits and investigations of program and operations areas; as the need arises, we also evaluate those not scheduled for review. When evaluating new or proposed laws, we identify appropriate legislation for review by using the list of pending federal legislation prepared by the Board's law library, as well as information shared within the Inspector General community, and we coordinate with other Board programs that also review new and proposed legislation. We then independently analyze the effect that the new or proposed legislation may have on the efficiency and effectiveness of Board programs and operations. When reviewing new or proposed regulations or policies, we monitor program contributions to the proposals to ensure that programs are fulfilling their legally mandated responsibilities. We then conduct our own analyses of proposed regulations to assess their possible administrative effects and the risk of fraud, waste, and abuse under them.

Activity During the Reporting Period

During this reporting period, we assisted with audits and investigations by commenting on statutory and regulatory compliance issues during the planning phases and by addressing legal issues during the fieldwork and report preparation phases. We reviewed several Board regulations and policies in both their proposed and final forms. Legislative, statutory, and regulatory reviews that concentrate on economy and efficiency concerns are continuing in connection with specific audits and inquiries. We continued our review of legislation pending before the

Special Comment on Developments Affecting the Relative Independence of OIGs

current Congress that would affect the Federal Reserve System. These reviews covered portions of the Federal Reserve Act, the Bank Holding Company Act, the federal information resources acts and the regulations that implement those acts, the Ethics in Government Act, and the Fair Labor Standards Act. The reviews also covered pending legislation that, by amending one or more of those acts, would affect the burdens the acts place on regulated entities and would alter the effects they have on the public.

Recently, questions have been raised regarding the independence of Inspectors General (IGs), particularly those serving in the Designated Federal Entities (DFEs). The first question resulted from actions taken by the American Institute of Certified Public Accountants which suggest that while presidentially appointed IGs would be sufficiently independent to satisfy the generally accepted accounting standards, DFE IGs are not sufficiently independent to satisfy the standards because DFE IGs are appointed by the agency head rather than the President.

The second question results from two recent rulings by the Federal Labor Relations Authority (FLRA). In both instances (one involving a presidentially appointed IG and the other involving a DFE IG), the FLRA is of the opinion that OIGs are part of an agency's "management" rather than independent within the agency. The ruling involving the presidentially appointed OIG is currently being considered by the U. S. Supreme Court. In the DFE IG ruling, however, the Administrative Law Judge explicitly distinguished the DFE case from the Supreme Court case solely on the basis that DFE IGs are appointed by the agency head rather than the President and,

therefore, lack the necessary independence from agency management. Regardless of the result of the Supreme Court case, DFE IGs would continue to be regarded as part of “management” by the FLRA.

The DFE IGs have long believed that the intent of the Inspector General Act Amendment of 1988 was to provide them with the same level of independence as presidentially appointed IGs. Although these developments have not directly or indirectly affected the independence of our operations, the questions from outside the IG community regarding independence, particularly in the case of DFE IGs, are becoming more frequent. Currently, the General Accounting Office (GAO) is revising its generally accepted government accounting standards which all OIGs are required by the Inspector General Act to follow when conducting audits. One area under consideration for revision is the “independence” standard. DFE IGs have been working with GAO on these revisions, and although GAO can be expected to properly address this issue, future congressional actions may be necessary if questions regarding IG independence continue to be raised.

Appendix

Cross-References to the Inspector General Act

Indexed below are the reporting requirements prescribed by the Inspector General Act of 1978, as amended for the reporting period:

<u>Section</u>	<u>Source</u>	<u>Page</u>
4(a)(2)	Review of Legislation and Regulations	32
5(a)(1)	Significant Problems, Abuses, and Deficiencies	None
5(a)(2)	Recommendations with Respect to Significant Problems, Abuses, and Deficiencies	None
5(a)(3)	Significant Recommendations Described in Previous Semiannual Reports on Which Corrective Action Has Not Been Completed	None
5(a)(4)	Matters Referred to Prosecutory Authorities	31
5(a)(5)	Summary of Instances Where Information Was Refused	None
5(a)(6)	List of Audit Reports	6
5(a)(7)	Summary of Significant Reports	None
5(a)(8)	Statistical Table–Questioned Costs	18
5(a)(9)	Statistical Table–Recommendations That Funds Be Put to Better Use	19
5(a)(10)	Summary of Audit Reports Issued Before the Commencement of the Reporting Period for Which No Management Decision Has Been Made	None
5(a)(11)	Significant Revised Management Decisions Made During the Reporting Period	None
5(a)(12)	Significant Management Decisions with Which the Inspector General is in Disagreement	None